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No. 88-181

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

HOUSTON LIGHTING & POWER COMPANY,
Appellant,

v.

PUBLIC UTILITY COMMISSION OF TEXAS,
Appellee.

On Appeal from the Supreme Court of Texas

REPLY TO APPELLEE'S MOTION TO DISMISS OR AFFIRM

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RULE 28.1 STATEMENT

Pursuant to Rule 28.1, appellant notes that there have been no changes in the parent company, subsidiaries, and affiliates of Houston Lighting & Power Company since the Jurisdictional Statement was filed.

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In its motion to dismiss or affirm, appellee Public Utility Commission of Texas ("Appellee" or the "PUC") argues that the appeal of Houston Lighting & Power Company ("HL&P") should be dismissed because (i) the federal questions were not timely raised and (ii) no substantial federal questions have been presented. Those arguments miss their mark. Appellee has failed either to show that this Court lacks jurisdiction or to rebut the Jurisdictional Statement's demonstration that this appeal presents federal questions of national importance.

I. This Court Has Jurisdiction Because HL&P Raised the Federal Questions Before the PUC and the Texas Courts.

Section 16(e) of the Texas Administrative Procedure Act provides that parties to a proceeding before the PUC may not challenge the PUC's order in court without first raising their objection with the PUC through a motion for rehearing. Tex. Rev. Civ. Stat. Ann. art. 6252-13a, § 16(e) (Supp. 1988). Appellee contends that HL&P failed to raise the takings clause issue presented by this appeal in its motion for rehearing before the PUC. By its own record and case citations, however, Appellee shows that HL&P did preserve the federal question.

HL&P's motion for rehearing before the PUC asserted that "The Commission Erred in its Findings of Fact and Conclusions of Law Relating to the Allens Creek Cancellation." Under that heading appeared a subsection entitled "The Improper Treatment of Federal Income Taxes Associated with Allens Creek Cancellation," in which HL&P made the same argument now presented in its Jurisdictional Statement: that the Commission improperly allocated to ratepayers the tax benefits associated with the disallowed costs of the Allen's Creek Nuclear Project ("ACNP"). As shown in Appellee's Appendix 1, paragraph B, the motion for rehearing stated that unless the PUC's order were changed to correct the errors enumerated, "HL&P will have been denied its rights to due process of law and will suffer confiscation of its property in contravention of the guarantees of the Constitutions of the United States and the State of Texas."

Under the Texas cases that Appellee cites, HL&P's motion for rehearing before the PUC plainly was sufficient to preserve the federal issues for purposes of section 16(e). In *Suburban Utility Corp. v. Public Utility Commission*, 652 S.W.2d 358 (Tex. 1983), the Texas Supreme Court ruled that the purpose of a motion for rehearing under section 16(e) is simply to give the agency notice that the

movant is dissatisfied with the agency's ruling and will appeal unless the ruling is changed. The motion need only be "sufficiently definite to apprise the regulatory agency of the error claimed and to allow the agency opportunity to correct the error or to prepare to defend it." *Id.* at 365. The court specifically rejected the suggestion that a motion for rehearing should be as specific as pleadings required in judicial proceedings. *Id.* at 364. The PUC therefore had adequate notice of both HL&P's dissatisfaction with the agency's ruling and the legal basis for the dissatisfaction.

HL&P preserved the federal issues raised before the PUC throughout proceedings in the Texas courts. Appellee's contention that HL&P waived its federal constitutional claims because they were not addressed by the Texas courts ignores the procedural history of this case. HL&P's pleadings in the state district court repeated the claims of error presented in its motion for rehearing before the PUC. The district court and the court of appeals did not reach HL&P's federal constitutional claims because they ruled for HL&P on state law grounds. They concluded that state law requires tax benefits to follow the investment to which the benefits relate. *See* App. at 27a-30a, 38a. Texas courts are prohibited by state law from addressing a constitutional issue if the case can be decided on other grounds. *Baptist Hospital v. Baber*, 714 S.W.2d 310 (Tex. 1986); *San Antonio General Drivers & Helpers Local 657 v. Thornton*, 299 S.W.2d 911, 915 (Tex. 1957). The first opportunity for the state courts to address the federal issues came only when the Texas Supreme Court reversed the court of appeals' and district court's rulings. At that point, HL&P promptly, properly, and precisely raised the federal constitutional issues in its motion for rehearing before that court.[1] *See*

[1] The specificity with which HL&P raised its federal constitutional claims, both in its motion for rehearing before the PUC and in its petition for rehearing before the Texas Supreme Court, distinguish

Appellant's Supplemental Appendix, *infra*; *see also Singleton v. Pennington*, 568 S.W.2d 367, 375 (Tex. Civ. App. 1978), *rev'd on other grounds*, 606 S.W.2d 682 (Tex. 1980); *Wright v. Gernandt*, 559 S.W.2d 864, 872 (Tex. Civ. App. 1977).

II. The Federal Questions Presented by This Case Are Substantial.

The central question presented by this appeal is whether *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), provides the appropriate standard of review where state utility regulators have taken nonutility property in order to reduce rates. Appellee argues that the appeal raises no substantial question because the PUC's decision to allocate tax benefits to ratepayers was merely part of an overall rate calculation reviewable under *Hope*. By assuming that *Hope* governs, Appellee completely overlooks the important constitutional question presented. The standard of review set by *Hope* and its progeny determines the adequacy of compensation received by utilities through rates for the value of utility property dedicated to public use. That standard does not apply here, where the PUC has appropriated the value of *nonutility* property and used it to reduce rates payable for the public use of *utility* property. Appellee's response does not show that there is no substantial federal question; it instead demonstrates the blindness of state regulators to an important constitutional issue on which this Court's guidance sorely is needed.

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this case from *Bankers Life & Casualty Co. v. Crenshaw*, 108 S.Ct. 1645 (1988), in which this Court recently ruled that claims under the contract and due process clauses had not been raised properly in a petition for rehearing before the Mississippi Supreme Court. In that case, the appellant alleged only that the punitive damage award "was clearly excessive, not reasonably related to any legitimate purpose, constitutes excessive fine, and violates constitutional principles." *Id.* at 1649.

III. The Allocation to Ratepayers of Tax Benefits for Disallowed Investment Is An Unconstitutional Taking.

HL&P's abandonment loss deduction for ACNP reduces the amount of federal income tax paid, but not the amount actually incurred with respect to public utility operations. Appellee contends that if the PUC had not awarded to ratepayers the entire tax benefit associated with that deduction, HL&P would have recovered through rates a "hypothetical expense"—a tax expense it would not actually incur. Appellee completely misunderstands the tax accounting principles involved here. HL&P incurs tax expenses related to the provision of utility services. Whether it pays those expenses with cash or by offsetting income tax deductions against them, the expenses nonetheless actually are incurred.

The relevant fact, which Appellee ignores, is that the tax deductions used to offset utility tax expense in this case related to nonutility property. The PUC allocated to ratepayers not just the tax deductions associated with the ACNP investment included in rate base, but also the deductions associated with the disallowed investment. HL&P is entitled to enjoy the benefit of the deductions relating to the ACNP investment for which it will receive no rate recovery. Otherwise, the PUC will have taken the value of nonutility property without compensation and awarded it to the ratepayers in further reduction of their rates for the use of utility property.[2]

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[2] The distinction between utility and nonutility property is not just an accounting mechanism as Appellee asserts. That distinction is central to a state's power to regulate utility rates and to the question whether a utility has received just compensation under the Fifth Amendment for the use of its property. While the state has the power to regulate the amount of compensation a utility receives for the dedication of its *utility* property to public use, it has no power to bestow on the ratepayers the value of *nonutility* property that has not been dedicated to the public use. *Brooks-Scanlon Co. v. Railroad Commission*, 251 U.S. 396 (1920), so holds. *See* Jurisdictional Statement at 16.

Appellee's reliance on *Federal Power Commission v. United Gas Pipe Line Co.*, 386 U.S. 237 (1967), as support for the PUC's method of calculating taxes is unwarranted. That case ruled only that the method of calculation involved there was permissible as a matter of regulatory accounting; the constitutional question at issue here involving the proper allocation of tax benefits associated with nonutility property was not addressed.[3]

IV. The Allocation of Tax Benefits for Disallowed Investment Without Any Basis in the Record Is a Denial of Due Process.

Appellee's own Appendix at page 5a, paragraph M, shows that HL&P specifically preserved its federal due process claim for review. The hearing examiner's report on ACNP, found in HL&P's Appendix at 113a-139a, shows the basis for that claim. That report contains no mention of the allocation of tax benefits because the issue was not raised or addressed in the agency hearing. Moreover, the record of the hearing contains no evidence showing how the benefits were to be calculated.[4] The PUC's decision on this issue was arbitrary, capricious, and without any basis in the record. The decision therefore denied HL&P's federal constitutional right to due process.

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[3] Appellee's contention that the PUC's decision passes constitutional muster because it does not prevent HL&P from taking the tax deduction begs the question entirely. Whether the PUC forbids HL&P to take the tax deduction or, as actually happened, permits it to take the deduction but lowers rates by a concomitant amount, the economic result is exactly the same. Under the circumstances, HL&P's ability to enter the deduction on its tax return is a hollow pleasure.

[4] The "additional explanation" of the calculation to which the Appellee refers, Appellee's Motion at 17, was an internal PUC staff memorandum not disclosed to HL&P until after the PUC had entered its final order.

CONCLUSION

For the reasons stated here and in the Jurisdictional Statement, the Court should note probable jurisdiction and set this case for argument. The federal questions were properly raised and preserved for appeal, and they present issues of national importance to the utility industry.

Respectfully submitted,

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SUPPLEMENTAL APPENDIX

Excerpts from HL&P's Motion for Rehearing Before the Supreme Court of Texas

A. At Page 3:

II.

The Court's opinion and judgment is in error in holding and decreeing that "The utility's rates must reflect the tax liability actually incurred" because such holding, if construed to require inclusion of tax savings arising from non-utility costs or expenses in the determination of tax liability, violates fundamental concepts of utility ratemaking adopted by statute, and results in an unconstitutional taking of property for public use without compensation.

B. At Page 8:

VII.

The Court's holding that the tax savings generated from the $166 million of disallowed ACNP expenses should inure to the benefit of ratepayers is in error because it is a taking of private property for public use without just compensation, and is unconstitutional.

C. At Page 9:

The allocation to ratepayers of the tax benefits associated with the $166 million ACNP cancellation loss denies HL&P the just compensation guaranteed by the Texas and U.S. Constitutions in two distinct ways—taking property from HL&P's shareholders for public use without just compensation and setting rates which deny HL&P the recovery of its prudent operating expenses.

D. At Page 10:

VIII.

The Court's holding that the tax savings generated from the $166 million of disallowed ACNP expenses should inure to the benefit of ratepayers is in error because it is a violation of constitutional due process requirements.

E. At Page 10:

The allocation to ratepayers of the tax benefits related to the $166 million in disallowed ACNP investment constitutes an unreasonable and arbitrary deviation from well established and accepted accounting and regulatory principles, violating both the due process and equal protection clauses of the Texas and United States Constitutions.

F. At Page 11:

HL&P has been deprived of procedural due process concerning the treatment of the tax savings. No evidence was presented and no arguments were made at the hearing regarding the tax treatment of the $166 million disallowance. The Examiner's Report did not discuss the tax treatment. The issue was first addressed in the Commission's Final Order. That Order was without evidentiary basis.